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Mexican Tortillas Assure Carstens Lending Rate Can Stay Steady
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By Jonathan J. Levin

July 28 (Bloomberg) -- Corn tortillas in northwest Mexico City cost 9 pesos a kilogram (32 cents a pound) last month. Angeles Garcia recorded the same price in her notebook after visiting a bakery in the neighborhood a week ago.

That's a relief for her boss, Mexican central bank Governor Agustin Carstens, as he seeks to tame inflation. Garcia, 65, is part of a 91-person team based in 46 Mexican cities whose daily trips to supermarkets, funeral homes and travel agencies produce the raw data for the country's consumer price index.

"It's been very stable here," said Garcia, who as an inflation surveyor for 29 years saw prices more than double in 1987. "It's not like the olden days."

Mexico's consumer prices fell every month in the second quarter, the longest period of deflation since at least 1973, easing average annual consumer price increases this year to the slowest since 2007. Government bonds are rallying as the readings cement economists' expectations that central bank policy makers can keep interest rates at a record low to stimulate economic growth without fanning inflation.

Mexico's benchmark 10 percent peso-denominated bonds due in 2024 climbed the past two months, pushing yields below 7 percent on July 15 for the first time on record. The bonds yielded 6.93 percent yesterday.

Yields on Mexico's peso-denominated bonds due in 2036 and 2038 also will drop below 7 percent, said Alberto Bernal, the head of fixed-income research at Bulltick Capital Markets, the Miami-based brokerage focused on Latin America. The bonds due in 2036 yielded 7.35 percent and the 2038 bonds yielded 7.4 percent yesterday.

'Long Exposure'

"The market consensus remains too bearish on inflation," said Bernal, who forecasts prices will rise 4.1 percent this year. "I would definitely not get out of long exposure in Mexico right now; I wouldn't even think about it."

Mexico economists estimate that the annual inflation rate will rise to 4.66 percent at the end of 2010, according to a monthly central bank survey.

While consumer prices increased in the first half of July, the 0.15 percent 15-day inflation reading lagged behind analysts' expectations for a 0.25 percent increase, according to the median estimate of 12 economists surveyed by Bloomberg.

The rise in fruit and vegetable prices was evident this month at Wal-Mart de Mexico SAB's Superama grocery store in the capital's Lindavista neighborhood, according to the inflation surveyor Garcia. White onions rose to 12.9 pesos a kilo in the second week of the month, from 10.5 pesos the week before, she said.

Core Inflation

Tortillas are the biggest food component in Mexico's inflation index. The cornmeal-based flatbread sells for an average of 8.69 pesos per kilogram in Mexico City, down from 8.70 pesos in May, according to Economy Ministry data.

Core prices, which exclude food and energy, are likely to keep inflation in check, even as perishable fruits and vegetable prices bottomed out and began to rise again this month, said Jimena Zuniga, an economist at Barclays Capital in New York.

Banco de Mexico's board may revise its year-end inflation estimate down 0.25 percentage point to between 4.5 percent and 5 percent in its quarterly inflation report today, she said.

Central bank Deputy Governor Manuel Sanchez said June 29 in Mexico City that the country is headed toward 3 percent inflation by 2011, which would put Mexico in line with its target for the first time since May 2006.

The central bank may even reduce its benchmark lending rate, which has been at a record-low 4.5 percent for more than a year, according to Enrique Solorzano, who manages 161 billion pesos at ING Groep NV's Mexican pension fund, the best performer in the country during the past three years, according to the website of Mexico's pension fund regulator, Consar.

Rate Outlook

The central bank may shave as much as 0.5 percentage point off the overnight rate by year-end, Solorzano said, according to a July 5 interview with Bloomberg News in Mexico City.

The outlook for rates depends on the strength of the peso and the economy in the U.S., which buys about 80 percent of Mexico's exports, said Luis de la Calle, the Mexican economist who helped negotiate the North American Free Trade Agreement. A peso rally would force the bank to lower rates this year because it would staunch exports by making them more expensive in dollar terms, he said.

"They'd get nervous and would lower the interest rate," said De La Calle, who is now a partner at Mexico City-based business adviser De la Calle, Madrazo, Mancera SC.

Economic Recovery

Economists have raised forecasts for Mexican growth on speculation the nation's manufacturers will benefit from revived U.S. demand for goods from refrigerators to cars, boosting Mexican employment, incomes and consumption. Mexico's gross domestic product will expand 4.4 percent this year, up from a 3.3 percent projection in January, as it recovers from the deepest recession since 1932, according to the average estimate of economists in a Banco de Mexico survey published July 1.

Carstens has no reason to cut interest rates, said Fernando Alvarez Toca, chief executive officer of Banco Compartamos SA, the Mexican bank that lends to low-income consumers.

"Mexico is already seeing signs of a recovery," Alvarez Toca said.

By keeping rates on hold, the bank is closing in on its inflation target while helping the economy rebound, according to Paulo Leme, chief Latin America economist at Goldman Sachs Group Inc., speaking from Miami.

"Some observers derogatorily labeled Carstens a dove," Leme said. "He has the right neutral stance. In terms of monetary policy, you always have to be ahead of the curve."

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